

20. Education or training costs, for provider staff, which exceed the provider's approved budget costs.
21. Employee benefits not offered to all full-time employees.
22. Entertainment costs.
23. Equipment costs for any equipment, whether owned or leased, not exclusively used by the facility except to the extent that the facility demonstrates to the satisfaction of the department that any particular use of the equipment was related to client services. Equipment used for client services, other than developmental disabilities contract services, will be allocated by time studies, mileage, client census, percentage of total operational costs, or otherwise as determined appropriate by the department.
24. Expense or liabilities established through or under threat of litigation against the state of North Dakota or any of its agencies; provided, that reasonable insurance expense shall not be limited by this subsection.
25. Federal and other governmental income taxes.
26. Fringe benefits exclusive of Federal Insurance Contributions Act, unemployment insurance, medical insurance, workers compensation, retirement, and other benefits which have received written prior approval of the department.
27. Fundraising costs, including salaries, advertising, promotional, or publicity costs incurred for such a purpose.
28. Funeral and cemetery expenses.
29. Goodwill.
30. Home office costs when unallowable if incurred by facilities in a chain organization.
31. Housekeeping staff or services costs.
32. In-state travel not directly related to industry conferences, state or federally sponsored activities, or client services.
33. Interest cost related to money borrowed for funding depreciation.
34. Items or services, such as telephone, television, and radio, which are located in a client's room and which are furnished solely for the convenience of the clients.
35. Key man insurance.

INITIAL NO. 91-01
Date Approved 10/7/92
Effective Date 10/1/90
Supersedes Transmittal 84-1

36. Laboratory salaries and supplies.
37. Staff matriculation fees and fees associated with the granting of college credit.
38. Meals and food service in day service programs.
39. Membership fees or dues for professional organizations exceeding five hundred dollars in any fiscal year.
40. Miscellaneous expenses not related to client services.
41. Out-of-state travel expense which is not directly related to client services or which has not received written prior approval by the department.
42.
 - a. Except as provided in subdivisions b, c, and d payments to members of the governing board of the provider, the governing board of a related organization, or families of members of those governing boards, including spouses and persons in the following relationship to those members or to spouses of those members: parent, stepparent, child, stepchild, grandparent, step-grandparent, grandchild, step-grandchild, brother, sister, half brother, half sister, stepbrother, and stepsister.
 - b. Payments made to a member of the governing board of the provider to reimburse that member for reasonable and actual expenses incurred by that member in the conduct of the provider's business may be allowed.
 - c. Payments for a service or product unavailable from another source at a lower cost may be allowed except that this subdivision may not be construed to permit the employment of any person described in subdivision a except as provided in subdivision d.
 - d. For-profit organizations may compensate working owners and family members described in subdivision a for time worked on behalf of the organization.

(1) The amount of total annual compensation allowed for an owner or owners acting in an executive or administrative capacity is limited as follows:

(a) Number of Clients Served	Compensation Limit
1-15	\$25,000
16-30	\$35,000
31-45	\$45,000
46+	\$50,000

TN No. 95-010
Supersedes
TN No. 94-005

Approval Date 05/24/96

Effective Date 07/01/95

- (b) The compensation limit in subparagraph (a) is the limitation on the aggregate compensation allocable to North Dakota facilities of all owners in any one year regardless of the number of owners performing work for the organization.
 - (c) Total compensation for owners who perform services for facilities in more than one state must be prorated on the basis of individual time distribution records.
 - (d) The compensation limit is inclusive of all salaries and related fringe benefits, and may not be construed to be an addition or enhancement to the budget.
- (2) Compensation for a family member working in a direct care, housekeeping, maintenance, dietary, or clerical position is limited to the wage paid to a nonrelated employee, with the same qualifications and experience, working in a similar job function for the organization.
- 43. Penalties, fines, and related interest and bank charges other than regular service charges.
 - 44. Personal purchases.
 - 45. Pharmacy salaries.
 - 46. Physician and dentist salaries.
 - 47. Production costs, such as the cost of the finished goods or products that are assembled, altered, or modified, square footage that the department determines is primarily for nontraining or production purposes, and property, equipment, supplies and materials used in nonfacility-based day and work activity.
 - 48. Religious salaries, space, and supplies.
 - 49. Salary costs of employees determined by the department to be inadequately trained to assume assigned responsibilities, but where an election has been made to not participate in appropriate training approved by the department.
 - 50. Salary costs of employees who fail to meet the functional competency standards established or approved by the department.
 - 51. Travel of clients visiting relatives or acquaintances in or out of state.
 - 52. Travel expenses in excess of state allowances.
 - 53. Undocumented expenditures.

TN No. 95-010
Supersedes
TN No. 94-005

Approval Date 05/24/96

Effective Date 07/01/95

54. Value of donated goods or services.
55. Vehicle and aircraft costs not directly related to provider business or client services.
56. X-ray salaries and supplies.

Section 14 - Maximum Annual Return on Investment

For-profit institutions or facilities must be allowed an annual return on investment in fixed assets based upon the existing debt over the original asset cost and must be determined as follows:

Percent debt to asset	Return
51% to 80 percent -	2 percent return on original cost of fixed assets.
0 to 50 percent -	3 percent return on original cost of fixed assets.

TN No. 90-010
Supersedes
TN No. NEW

Approval Date 05/24/96

Effective Date 07/01/95

Section 15 - Depreciation

1. The principles of reimbursement for provider costs require that payment for services should include depreciation on depreciable assets that are used to provide allowable services to clients. This includes assets that may have been fully or partially depreciated on the books of the provider, but are in use at the time the provider enters the program. The useful lives of such assets are considered not to have ended and depreciation calculated on the revised extended useful life is allowable. Likewise, a depreciation allowance is permitted on assets that are used in a normal standby or emergency capacity. Depreciation is recognized as an allocation of the cost of an asset over its estimated useful life. If any depreciated asset is sold or disposed of for an amount in excess of its undepreciated value, the excess represents an overstatement of the cost of the asset to the facility.
2. Depreciation methods are as follows:
 - a. The straight-line method of depreciation must be used. The method and procedure for computing depreciation must be applied on a basis consistent from year to year and detailed schedules of individual assets must be maintained. If the books of account reflect depreciation different than that submitted on the cost report, a reconciliation must be prepared.
 - b. Depreciation will be computed using a useful life of ten years for all items except vehicles, which shall be four years, and buildings, which shall be twenty-five years or more. A different useful life may be used; however, when the useful life selected differs significantly from that established by the guidelines, the deviation must be based on convincing reasons supported by adequate documentation, generally describing the realization of some unexpected event.
3. Acquisitions are treated as follows:
 - a. If a depreciable asset has, at the time of its acquisition, a historical cost of at least three hundred dollars, or if it is acquired in quantity and the cost of the quantity is at least five hundred dollars, its cost must be capitalized and depreciated in accordance with subdivision b of subsection 2. Cost during the construction of an asset, such as architectural, consulting and legal fees, interest, etc., should be capitalized as a part of the cost of the asset.
 - b. Major repair and maintenance costs on equipment or buildings must be capitalized if they exceed five thousand dollars and will be depreciated in accordance with subdivision b of subsection 2.

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Date Approved 10/7/92
Effective Date 10/1/90
84-1

4. Proper records will provide accountability for the fixed assets and also provide adequate means by which depreciation can be computed and established as an allowable client-related cost.
5. The basis for depreciation is as follows:
 - a. The amount of historical costs shall not exceed the lower of:
 - (1) Current reproduction costs less straight-line depreciation over the life of the asset to the time of purchase; or
 - (2) Fair market value at the time of purchase.

In the case of a trade-in, the historical cost will consist of the sum of the book value of the trade-in plus the cash paid.
 - b. For depreciation and reimbursement purposes, donated depreciable assets may be recorded and depreciated based on their fair market value. In the case where the provider's records do not contain the fair market value of the donated asset, as of the date of the donation, an appraisal must be made. An appraisal made by a recognized appraisal expert will be accepted for depreciation.
 - c. No provision shall be made for increased costs due to the sale of a facility.
6. Providers which finance facilities pursuant to North Dakota Century Code chapter 6-09.6, subject to the approval of the department, may elect to be reimbursed based upon the mortgage principle payments rather than depreciation. Once an election is made by the provider, it may not be changed without department approval.
7. Recapture of depreciation.
 - a. At any time that the operators of a facility sell an asset, or otherwise remove that asset from service in or to the facility, any depreciation costs asserted after June 1, 1984, with respect to that asset, are subject to recapture to the extent that the sale or disposal price exceeds the undepreciated value except as provided in paragraphs (1) and (2). If the department determines that a sale or disposal was made to a related party, or if a facility terminates participation as a provider of services in a department program, any depreciation costs asserted after June 1, 1984, with respect to that asset or facility, are subject to recapture to the extent that the fair market value of the asset or facility exceeds the depreciated value.
 - (1) If a facility has been owned for twenty years or longer, there may be no recapture of depreciation; or

TN No. 95-010
Supersedes
TN No. 91-01

Approval Date 05/24/96

Effective Date 07/01/95

- (2) If a facility has been owned for more than ten years but less than twenty years, the depreciation recapture amount must be reduced by ten percent times the number of years the facility is owned after the tenth year.

TN No. 95-010
Supersedes
TN No. New

Approval Date 05/24/96

Effective Date 07/01/95

- b. The seller and the purchaser may, by agreement, determine which shall pay the recaptured depreciation. If the parties to the sale do not inform the department of their agreement, the department will offset the amount of depreciation to be recaptured against any amounts owed, or to be owed, by the department to the seller and buyer. The department will first exercise the offset against the seller, and shall only exercise the offset against the buyer to the extent that the seller has failed to repay the amount of the recaptured depreciation.

Section 16 - Interest Expense

1. In general:

- a. To be allowable under the program, interest must be:
- (1) Supported by evidence of an agreement that funds were borrowed and that payment of interest and repayment of the funds are required;
 - (2) Identifiable in the provider's accounting records;
 - (3) Related to the reporting period in which the costs are incurred;
 - (4) Necessary and proper for the operation, maintenance, or acquisition of the provider's facilities used therein;
 - (5) Unrelated to funds borrowed to purchase assets in excess of cost or fair market value; and
 - (6) When representative of borrowing for the purpose of making capital expenditures for assets that were owned by any other hospital, facility, or service provider on or after July 18, 1984, limited to that amount of interest cost which such hospital, facility, or service provider may have reported, for ratesetting purposes, had the asset undergone neither refinancing nor a change of ownership.
- b. In such cases where it was necessary to issue bonds for financing, any bond premium or discount shall be accounted for and written off over the life of the bond issue.

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2. Interest paid by the provider to partners, stockholders, or related organizations of the provider is not allowable as a cost except when interest expense is incurred subject to North Dakota Century Code chapter 6-09.6.
3. A provider may combine or "pool" various funds in order to maximize the return on investment. Where funds are pooled, proper records must be maintained to preserve the identity of each fund in order to permit the earned income to be related to its source. Income earned on gifts and grants does not reduce allowable interest expense.
4. Funded depreciation requirements are as follows:
 - a. Funding of depreciation is the practice of setting aside cash or other liquid assets to be used for replacement of the assets depreciated or for other capital purposes. The deposits are, in effect, made from the cash generated by the noncash expense depreciation.
 - b. Deposits to the funded depreciation account are generally in an amount equal to the depreciation expense charged to costs each year. In order to qualify for all provisions of funding depreciation, the minimum deposits to the account must be fifty percent of the depreciation expensed that year. Deposits in excess of accumulated depreciation are allowable; however, the interest income generated by the "extra" deposits will be considered as a reduction of allowable interest expense. This provision is recommended as a means of conserving funds for the replacement of depreciable assets. It is expected that the funds will be invested to earn revenues. The revenues generated by this investment will not be considered as a reduction of allowable interest expense provided such revenues remain in the fund.
 - c. Monthly or annual deposits representing depreciation must be in the funded depreciation account for six months or more to be considered as valid funding transactions. Deposits of less than six months are not eligible for the benefits of a funded depreciation account. However, if deposits invested before the six-month period remain in the account after the six-month period, the investment income for the entire period will not reduce the allowable interest expensed in that period. Total funded depreciation in excess of accumulated depreciation on client-related assets will be considered as ordinary investments and the income therefrom will be used to offset interest expense.
 - d. Withdrawals for the acquisition of capital assets, the payment of mortgage principal on these assets and for other capital expenditures are on a first-in, first-out basis.

91-01
Date Approved 10/7/92
Effective Date 10/1/90
Supersedes Transmittal 84-1

- e. The provider may not use the funds in the funded depreciation account for purposes other than the improvement, replacement, or expansion of facilities or equipment replacement or acquisition related to client services.
- f. Existing funded depreciation accounts must be used for all capital outlays in excess of three hundred dollars except with regard to those assets purchased exclusively with donated funds or from the operating fund, provided no amount was borrowed to complete the purchase. Should funds be borrowed, or other provisions not be met, the entire interest for the funded depreciation income account will be offset up to the entire interest expense paid by the facility for the year in question.

Section 17 - Related Organization

- 1. Costs applicable to services, facilities, and supplies furnished to a provider by a related organization shall not exceed the lower of the cost to the related organization or the price of comparable services, facilities, or supplies purchased elsewhere primarily in the local market. Providers must identify such related organizations and costs in the cost report. An appropriate statement of cost and allocations must be submitted with the cost report. For cost reporting purposes, management fees will be considered administrative costs.
- 2. A chain organization consists of a group of two or more service providers which are owned, leased, or through any other device, controlled by one business entity.
- 3. Home offices of chain organizations vary greatly in size, number of locations, staff, mode of operations, and services furnished to their member facilities. Although the home office of a chain is normally not a provider in itself, it may furnish to the individual provider, central administration or other services such as centralized accounting, purchasing, personnel, or management services. Only the home office's actual cost of providing such services is includable in the provider's allowable costs under the program. Any services provided by the home office which are included in cost as payments to an outside provider will be considered a duplication of costs and not be allowed.

Transmittal NO. 91-01
Date Approved 10/7/92
Effective Date 10/1/90
Supersedes Transmittal 84-1